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SUBJECT: The Japan Economic Scope--July 26, 2007

Sensitive but unclassified. Please protect accordingly.

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[1](#)3. (SBU) Deputy Secretary Set to Arrive in Tokyo

On his return from the Asian Regional Forum in Manila, Deputy Secretary Negroponte will stop in Tokyo for bilateral meetings

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August 3.

For the Embassy's scene-setter, please see Tokyo 3399. David DiGiovanna is the control officer for the visit.

[1](#)4. (U) Niigata Earthquake: Damage Toll Mounts

Authorities are still totaling up the damage after an earthquake hit Japan's Niigata Prefecture on July 16. The prefecture puts the losses at about 1.5 trillion yen, including 700 million yen

worth of damage to the Kashiwazaki-Kariwa nuclear plants owned by Tokyo Electric Power Co.

Some 3000 people are still living in shelters in Kashiwazaki, according to press reports. Some 10,000 homes in the prefecture have been damaged or destroyed. The Ministry of Land, Infrastructure, and Transport (MLIT) estimated damage to area infrastructure at slightly above four billion yen.

The 6.8 magnitude quake killed 11 people and injured over 1000. "The quake was a typical disaster hitting a midsize city," Niigata Governor Hirohiko Izumida told reporters afterward. (ECON: Nicholas Hill)

15. (U) Kashiwazaki-Kariwa Shutdown Squeezes Tokyo's Electricity Supply -----

The shutdown of the Kashiwazaki-Kariwa nuclear plant, following the July 16 earthquake and resulting safety concerns, has taken offline roughly six million kW of electrical power, according to a press release by Tokyo Electric Power Company (TEPCO), which operates the plant and serves customers mainly in the Tokyo metropolitan area.

While the total capacity of Kashiwazaki-Kariwa's seven reactors is over eight million kW, three reactors were already scheduled for temporary shutdown to conduct routine inspection and maintenance.

TEPCO plans to mitigate the impact of the shutdown with about three million kW of additional supply by increasing output at other plants, including fossil fuel plants, and purchasing power from other utilities. If successful, these measures will bring TEPCO's supply for the peak summer months to roughly 62 million

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kW.

TEPCO officials have expressed confidence that they will be able to meet a forecasted seasonal peak demand of 61 million kW. Two fossil fuel power plants were already restarted in early July. Restarting some previously-retired fossil fuel plants, however, will require "at least a couple of months," according to one TEPCO representative. Moreover, purchasing additional power from other utilities may pose challenges.

In a severe heat wave, other Eastern Japan utilities, such as Tohoku or Hokkaido power companies, may not have spare capacity available, and transferring power from utilities in Western Japan is limited by the lack of transmission lines and the different frequency of the grid (60 hertz vs. TEPCO's 50 hertz).

TEPCO officials acknowledge that exceptionally high summer temperatures could increase demand above their forecast and are prepared to undertake demand management measures to curb customers' electricity usage during peak times. While peak demand on July 24, 2007, was just 48 million kW, in July 2001 peak demand topped out at over 64 million kW, according to TEPCO records. (EST: Thomas Wolf/Ayanna Hobbs/DOE: Ronald Cherry/Koichi Uchida)

16. (SBU) Earthquake Dents Japan's Auto Industry -----

By the time the Scope went to press, Japanese automakers had resumed production on most if not all of the lines shuttered because of the Niigata earthquake.

The Japanese media estimates that the twelve Japanese car makers would come up 120,000 vehicles short of their original production plans. This is three times the production shortfall caused by the earthquake that leveled Kobe in 1995.

The shutdown, however, is not expected to have a major impact on the automakers' overall production or bottom lines.

The main shutdown period of roughly July 19-24 spanned a weekend, and a Honda official reports that they can compensate for the lost production by boosting production in September.

One of the big investment houses shared their "instant" analysis with us and it estimates a loss of 20 billion yen per day of halted production collectively for the top eight auto firms, but notes this could be made up by the end of the year by increased production in the second and third quarters.

The Big Three Japanese automakers -- Toyota, Honda and Nissan -- all told the press that the shutdowns would not affect exports. Although the industry may have dodged a bullet this time, the quake revealed an unexpected vulnerability to Japanese manufacturing supply chains and has led to some fretting about other weak points, where one company has a large market share of a critical product.

Riken Company's Kashiwazaki plant produced about 50 percent of piston rings used by the vehicle manufacturers in Japan (as well as seal rings used in hydraulic systems on vehicles).

Other manufacturers have similarly large market shares, e.g.: Denso Corp. has 60 percent of the car air conditioner market; Asmo Co. supplies 53 percent of radiator fans; and Tokai Rika produces 49.4 percent of the electrical switches.

Consulate Nagoya, however, notes that Japanese automakers also may keep more inventory on hand than is generally understood, particularly for strategically important or single-sourced parts. On the plant floor, the famous just--in--time system may result in as little as two hours of inventory on hand, but depending on the part, nearby warehouses owned by the automakers can stock several days of supplies.

The carmakers expeditious sending of some 700 workers to the damaged Riken plant, moreover, demonstrated the resiliency of the production system when confronted by a disaster. An industry insider explained to us that much of the equipment used by the automakers to produce engines is similar to the machinery at Riken. Thus, with the closure of the production lines, maintenance workers and engineers could be deployed to

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Riken to repair the damage.

Despite the relative success of the industry's response, producers are hedging their bets.

Toyota announced it would reexamine its supply network to see if dominant manufacturers' production can be dispersed. The Japanese press, in addition, has highlighted other industries that are vulnerable to a disruption, the effects of which would not only be felt in Japan, but globally.

The Yomiuri warns that Kobe Steel's Moka plant in Moka and Furukawa Electric's Nikko plant, both in Tochigi Prefecture, are the sole world-wide manufactures of a substrate used in the production of hard disks for personal computers and HD-DVD players, and Kuraray Company has about 80 percent of the global market share in polyvinyl alcohol film, which is used for a liquid crystal displays.

The Yomiuri wrote that the 1995 Kobe earthquake heavily damaged Kobe Steel's facilities, greatly disrupting the production of wire rods for valve springs on vehicle engines; with Kobe Steel's 50 percent of the global market share, the production of autos around the world was affected. (ECON: Josh Handler)
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17. (SBU) Tour of Prefectures Indicate LDP is Heading for Defeat

As voting day approaches, Japanese pundits continue to predict a major defeat for the Liberal Democratic Party (LDP) in Upper

House elections. Embassy officers visited Yamagata, Tottori, Shimane, Aomori and other prefectures over the last 10 days to look at how the campaigns were shaping up throughout the country. Regional economic conditions appear to be playing a major role; the pension scandal and growing income gap are most commonly cited as serious concerns.

In the long-time LDP stronghold of Yamagata, for example, the loss of public works, the privatization of the postal service, and a shrinking agricultural base have left the party on the defensive and the Democratic Party of Japan (DPJ) candidate Yasue Funayama feeling confident she can defeat her female LDP counterpart Mieko Shinohara.

Tottori postal rebel Yoshihiro Kawakami is trying to make the most of his former LDP connections and support among the farming community while running on the DPJ ticket. By contrast, the race continues to be tight in Aomori, with the LDP still maintaining an edge. Divisions in RENGO Aomori are proving to be very problematic for the DPJ challenger Hirayama. (ECON: Joan Siegel and other contributors)

18. (SBU) Shimane Voters Tired of LDP and Pork Barrel Politics -- -----

An editor at the Shimane Nichi Nichi Shimbun communicated to the Osaka-Kobe Consulate General that Shimane voters are "sick of" Mikio Aoki (head of the Liberal Democratic Party (LDP) in the upper house) and his old style of pork-barrel politics.

Voters in Shimane view the old style of LDP machine politics as only benefiting a narrow segment of the population involved in the construction industry. They are now ready for a change, thanks to the shock administered by Koizumi and his economic reforms.

The Nichi Nichi Shimbun editor sees this as an economic maturation of the public in Shimane. For those further interested in Aoki's decline in power, a recent article from the Hokkoku Shimbun is attached below. (Osaka-Kobe: Phil Cummings/Scott Ravenhill)

19. (SBU) Quality Control Scandals in China Vex Japanese -----

While on a trip to China July 25-26, Agriculture Minister Akagi underscored Japanese concerns about food safety issues. An Agriculture Ministry (MAFF) official told us that Akagi's meeting with his Chinese counterpart, Du Qinglin, went well. The two countries will convene a meeting of experts to exchange information on food safety issues.

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The MAFF official told us that this is an approach that the Health Ministry (MHLW) has advocated and Akagi agreed to convey during his visit. In addition to meeting Du, Akagi met senior Chinese quarantine officials.

According to a Nikkei story on July 24, Japan is offering technological assistance to help China improve product safety standards. Both countries would investigate suspicious goods, looking closely at production and distribution problems. Chinese imports account for two percent of Japan's gross domestic product. The Japanese media has intensively covered the scandals over Chinese quality control safeguards, creating a consumer furor during Japan's Upper House election campaign. (ECON: Nicholas Hill/Ryoko Nakano)

110. (SBU) Japan and China to Team Up on Agriculture? -----

In addition to discussing food safety issues, an Agriculture Ministry (MAFF) source we spoke to said Japan's Agriculture Minister Akagi and his Chinese counterpart, Du Qinglin, both agreed they have problems with Crawford Falconer's draft

modalities text prepared for the Doha Round agriculture negotiations and released last week.

According to a GOJ press statement issued after the two ministers met, Akagi repeated concerns about the text being "unbalanced" against food importing countries. He said that Japan would continue to ask for modifications to the draft. For his part, Du Qinglin complained that the text was biased against newly-minted WTO members.

The two agriculture ministers agreed to collaborate in the future.

In particular, the Chinese are interested in acquiring agricultural technology from Japan and also know-how on insurance programs in the farm sector.

In addition to meeting Chinese government counterparts, Akagi was in China for a July 25 ceremony to promote high-grade Japanese rice sales in the Chinese market. Trade resumed in June after some intense bilateral negotiations. (ECON: Nicholas Hill/Ryoko Nakano)

¶11. (SBU) Criticism of Japan's Pork Gate Price System -----

Some consumer groups and industry sources want to see changes to the Japanese government's Gate Price System for pork.

The system protects Japan's market from foreign imports and distorts the market mechanism. Japan is the world's largest pork importer. U.S. exporters did more than \$1 billion dollars in business in 2006.

For more details, please see Tokyo 3394. (ECON: Nicholas Hill/FAS: Paul Spencer)

¶12. (SBU) Bilateral Beef Talks Resume -----

A second round of talks at the experts' level is set to resume in Tokyo August 1--2 to discuss Japan's restrictions on U.S. beef imports. The United States would like to see Japan adopt a more science-based approach consistent with World Animal Health Organization (OIE) standards.

USDA, FDA, USTR, and Embassy representatives will compose the U.S. delegation. Japan's delegation will be headed by officials from the Health Ministry (MHLW) and Agriculture Ministry (MAFF) and also be joined by officials from MOFA.

After the experts meetings, the Japanese government is expected to craft a recommendation for its independent Food Safety Commission on whether to ease currently onerous standards that ban U.S. beef from cows over 20 months old.

The United States would like to see Japan eliminate its age restrictions all together, a step which would be consistent with international standards. Japanese officials have not indicated that they are prepared to go that far, irrespective of what the

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OIE has recommended. (ECON: Nicholas Hill)

¶13. (U) Kansai Politicians Demand More International Flights from Itami -----

From conversations with Lower House Diet members Koichiro Ichimura, Democratic Party of Japan (DPJ), and Yasuhide Nakayama, Liberal Democratic Party (LDP), Osaka-Kobe Consulate General has learned that both politicians strongly support increasing international flights out of Itami, an airport located northwest of Osaka. They have been applying strong political pressure on the Ministry of Land, Infrastructure and Transportation (MLIT) and Minister Fuyushiba to support their priorities.

Ichimura, who represents Takarazuka near Itami, told the Consulate he had the support of the South Korean Embassy to start Itami-Pusan or Gimpo charters at an undecided date in September. The Korean Ambassador to Japan suggested a second city linkage between Pusan and Osaka, and Ichimura responded affirmatively to this proposal by promising to be on the first flight.

Nakayama was notably unsupportive of Kansai International Airport (KIX), citing its inconvenience from downtown Osaka. He spoke of the great demand for air service out of Itami, especially now that jet engines were quieter.

Nakayama is running a small benkyokai with Hankyu-Hanshin Rail, JR and academics on plans to make a Shinkansen stop in JR Osaka and/or Umeda Station so that business travelers would have a choice of Shin-Osaka or Osaka/Umeda.

He said this is made possible by Japanese land rights extending only a certain amount of meters below the surface, which opens up development of deep rail stations, similar to the Oedo Line in Tokyo. (Osaka-Kobe: Phil Cummings/Scott Ravenhill)

¶14. (SBU) METI Sees Mitsubishi Regional Jet (MRJ) as a Priority -----

METI officials told us this week that the MRJ project is a priority for them, but that Mitsubishi would decide next spring about moving toward production of the aircraft and METI has not yet decided they would support the project. Press reports statements about 30 percent funding by the GOJ were unfounded, since it may be more or less than that, according to the officials.

The METI officials implied that if a decision to support the project was made it would become apparent in the development of next year's budget which would be submitted to the Diet early next year.

Currently METI is supporting an ongoing R&D project for the MRJ through the New Energy and Industrial Technology Development Organization (NEDO).

METI was encouraged by the news that Boeing would provide some assistance to the project.

When asked what is METI's vision for the future of Japan's aircraft industry, the officials replied that full-scale production of a whole aircraft is necessary; there is a need to move beyond the production of just parts or sections of an aircraft. (ECON: Junko Nagahama/Josh Handler)

¶15. (SBU) No Boeing-MHI Cooperation on Regional Jet -- Yet -----

At a July 19 luncheon meeting with Nagoya PO, Boeing Japan President Nicole Piasecki and Mitsubishi Heavy Industry (MHI) Nagoya Aerospace Systems General Manager Yoji Yamada both denied Japanese press reports from the June Paris Air Show that Boeing and Mitsubishi had reached an agreement for Boeing to provide investment, marketing or production support for Mitsubishi's regional jet (MRJ) program.

In Paris, Mitsubishi debuted a mock-up of the composite materials-based, 70 to 90 seat MRJ, planned to start production in 2012. Given the long history of cooperation between Boeing and MHI and the fact that the MRJ would not compete with any Boeing products, but rather with planes from Bombardier, Embraer

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and others, many observers have speculated that MHI's project is ripe for participation by Boeing. Piasecki and Yamada both strongly emphasized that any Boeing role remained entirely speculative at this point.

Pointing to the successful Boeing--MHI cooperation on production of composite materials wings for the 787 Dreamliner, however,

Piasecki said it was not unrealistic to expect that Boeing and MHI would look closely at whether future cooperation on the MRJ was warranted in the regional jet sector of the market (in which Boeing currently does not participate). (Nagoya: Dan Rochman)

¶16. (SBU) Japan Civil Aviation: The Other Reforms

While the battle over expanding capacity at Tokyo's Narita and Haneda airports has grabbed most of the attention of the press and policy-makers since last September when Prime Minister Abe first proposed reform of Japan's aviation policy in his Asia Gateway Initiative, equally important for aviation reform are efforts to revise airport governance, airport fees, and airfares, which are still controlled or heavily influenced by the government.

Tokyo 3313, July 19, 2007, covers the Council for the Promotion of Regulatory Reform (CPRR) and the Japan Fair Trade Commission (JFTC)'s differences with the Ministry of Land, Infrastructure and Transport (MLIT) on these issues. (ECON: Josh Handler)

¶17. (SBU) Tokyo Civ Air Talks Round Up

Tokyo 3377, July 25, 2007, provides more information on State Transportation DAS John Byerly and DOT International Aviation Paul Gretch's civil aviation discussions with their Japanese counterparts, delves into the Japanese and U.S. political calendars' impact on the next few years of negotiations, gives some insights into Japan Airlines (JAL) financial situation, and supplies more background on the JFTC's work on anti-trust immunity for aviation agreements. (ECON: Josh Handler)

¶18. (U) Kitakyushu Ethanol from Food Waste Pilot Project

In June Nippon Steel Engineering launched a pilot project to process food waste into ethanol at Kitakyushu Eco Town in Kitakyushu City. Commissioned by the New Energy and Industrial Technology Development Organization (NEDO), the project is scheduled to last until March 2010. One of seven NEDO "Local Biomass Energy Systematization Projects," it is the first in Japan to produce ethanol from food waste.

Kitakyushu City established the system to collect and sort food waste with technologies developed by waste management company Nishihara Co.

Leftover food is collected primarily from supermarkets, restaurants, schools and hospitals. It is estimated that 10 tons of this food waste produces 400 liters of ethanol per day. The ethanol is then processed into three percent ethanol blend gasoline (E3 gasoline) and will be used as fuel for vehicles owned by Kitakyushu City and Nippon Steel.

To minimize costs, the ethanol production plant uses excess waste heat from a nearby incineration facility and the residue left after ethanol recovery is then burned in the same incinerator. Kitakyushu City officials stated that the most challenging aspect of this project has been the development of an efficient means of collecting and transporting food waste to the plant. (Fukuoka: Yuriko Funakoshi/James Crow)

¶19. (SBU) MOFA's New Maritime Headquarters to Check MLIT?

On July 20, the Ministry of Foreign Affairs (MOFA) established a Headquarters for Foreign Policy concerning Maritime Affairs headed by Shotaro Yachi, Vice-Minister for Foreign Affairs the same day the new Basic Maritime Law came into effect.

One of the provisions of this law is the establishment of a General Maritime Policy Headquarters, with the Ministry of Land, Infrastructure and Transport (MLIT) holding the highest position

among the member ministries. A July 24 Nikkei article says MOFA's move was not a coincidence and speculates that MOFA established its office to check MLIT's power in maritime affairs. According to MOFA's Senior Planning Officer for Ocean Affairs, Ryotaro Suzuki, the new MOFA-initiated headquarters' (HQ) members are from MOFA only. Its Secretariat Chief is the Director-General (DG) of the Economic Affairs Bureau, and it consists of some 20 DG-level members from different bureaus.

A MOFA press release says that the new MOFA HQ will serve to conduct faster and more effective comprehensive planning, coordination and policy-making regarding the overall foreign policy on maritime affairs.

As for the General Maritime Policy Headquarters, while the Prime Minister is nominal head, the Chief Cabinet Secretary and MLIT Minister are Deputy Chiefs, and the Foreign Minister joins the office as a member, a status lower than the Deputy Chief. Hiroshi Terashima, Executive Director for the Ocean Policy Research Foundation (OPRF) and a former Assistant Vice Minister of Transport, told us, that based on his experience as a key figure in establishing the Basic Maritime Law, that Nikkei probably came to its conclusion because MLIT had taken the initiative in making the law. MLIT finalized the law, and MLIT Minister Tetsuzo Fuyushiba became the first Maritime Minister while serving concurrently with his other duties. Terashima speculated that MOFA may be trying to regain some ground it has lost to MLIT.

Fuyushiba said in a July 24 press conference that he only learned of the MOFA HQ from the press report and had never heard about it directly from MOFA. He stated that he thinks that in principle the General HQ will lead maritime policy, but that does not mean it prohibits other GOJ offices from conducting established policy.

For more background, see Tokyo 2552. (EST: Keiko Kandachi/Bart Cobbs)

120. (U) Trade Figures Surge

If a growing current account surplus were the key to success in Japanese election politics, PM Abe would be sitting comfortably. According to preliminary government trade figures reported widely in the press on July 25 for the first six months of 2007, exports jumped 12.8 percent to just over 40 trillion yen, while imports grew 8.2 percent to just over 35 trillion yen.

According to the Nikkei, Japan's trade surplus with Asia surged 37.6 percent to 3.89 trillion yen, while its surplus with the United States declined 2.6 percent to 4.11 trillion yen. Exports fueled a decline in Japan's deficit with China of 17.6 percent. Japan's total trade with China was greater than its total trade with the United States for the second six month period in a row. The Nikkei cited Finance Ministry data that Japan's trade surplus in June expanded 53.4 from the same period in 2006, an eighth straight month of growth. (ECON: Nicholas Hill)

121. (SBU) A Japanese Perspective on Steel Partners

The chairman of office equipment maker Brother Industries, the target of two activist shareholder proposals by U.S.-based investment fund Steel Partners, told Nagoya PO that he fundamentally disagreed with Steel Partners' (Brother's largest shareholder) objectives in seeking sharply increased dividends, but he did not believe Steel Partners had any malicious intent. This differs with press characterizations of Steel Partners as a greenmailer, largely due to its dispute with the Bull-Dog Sauce Company. Foreign investment (virtually all by U.S. investment funds) in Brother has risen dramatically from less than 10 percent six years ago to nearly 40 percent today, and the firm's management says almost all foreign investors other than Steel Partners agree with its financial strategy. (Nagoya: Dan Rochman)

122. (SBU) Big Industrial Fish Lure Smaller Ones in Mie

Kanetaka Nakao, Director General for Agriculture, Commerce and Industry in Central Japan's Mie Prefecture, explained Mie's successful high tech investment promotion activities to visiting Nagoya PO on July 24.

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Spurred by Sharp and Fujitsu's mega-investments in LCD television production and Toshiba/Sandisk's in integrated circuit production, Mie's "Crystal Valley" and "Silicon Valley" projects have accumulated 78 firms in the flat panel display sector and 47 firms in the semiconductor sector, respectively.

Although a top selling point for Mie is its proximity to Nagoya and easy access to Osaka, the prefecture also offers some of the richest investment incentives in Japan, topping out at a nine billion yen package (\$73 million) of incentives paid out to a single manufacturer over 15 years.

In part, as a result of the spurt of high-tech investment, Mie's per capita manufacturing output is over twice the national average, and grew in 2005 at 7.6 percent, nearly double the national rate.

Nevertheless, Mie suffers from the same regional disparities that plague Japan as a whole. While there are about 200 jobs for every 100 job-seekers in the northern part of the prefecture, there are only about 50 jobs per 100 applicants in the south. (Nagoya: Dan Rochman)

123. (SBU) Borg-Warner's Mie Plant Takes on Asia-Wide Role -----

BorgWarner Morse Transmission and Engine Components (TEC) Japan Managing Director Mark Boshart explained the expanding regional role of BorgWarner's Nabari plant, Mie Prefecture, during a July 23 visit by Nagoya PO.

The Nabari plant was established 23 years ago to produce 4WD transfer chains (a market dominated by BorgWarner, with a 90-95 percent global market share) engine timing systems, and other parts for Japanese automakers but now also serves as a "mother plant" for expanding BorgWarner operations in China and India. Boshart noted that, owing to intellectual property concerns for products assembled in China, BorgWarner had maintained production of key components in Japan and had "dumbed down" some of its manufacturing assembly machines to be used in China.

With regards to the environment, Boshart said that when constructing its Ningbo, China plant, BorgWarner was required to build on a minimum of 90 percent of its land, compared a maximum area of 65-70 percent in Japan, which mandates green space on industrial plots.

Separately, Boshart said that one of the reasons he was sent to Nabari, succeeding a Japanese managing director, was to make sure BorgWarner's accounting and auditing procedures in Japan were Sarbanes-Oxley compliant. (Nagoya: Dan Rochman)
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